Supreme Court, U. S.
FILED
JAN 26 1980
MICHAEL RODAK, JR., CLERK

No. 79-927

# In the Supreme Court of the United States

OCTOBER TERM, 1979

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER

*v.*

INVESTMENT COMPANY INSTITUTE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT*

## REPLY MEMORANDUM FOR THE PETITIONER

WADE H. McCREE, JR.
*Solicitor General*
*Department of Justice*
*Washington, D.C. 20530*

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1. Respondent argues (Br. in Opp. 8-10) that the practical consequences of the decision below are "limited" and that "any adverse competitive impact will not be great." However, the court of appeals' decision has an immediate impact on bank holding companies now serving as investment advisers to closed-end investment companies, as well as on the shareholders of those companies. It also has an impact on other bank holding companies that do not now serve as investment advisers but may wish to do so in the future. Furthermore, respondent's argument about practical consequences fails to consider that the rationale of the decision below calls into serious question the permissibility of investment management activities by banks. As we have explained (Pet. 11 & n.12), banking organizations traditionally have provided investment

management services to closed-end investment companies. Despite the deterrent effect of the present litigation, fully one-third of the major closed-end investment companies that were organized after the effective date of the Board's regulation were organized by banking institutions.[1] A reversal of the decision below would permit significant new entry by both banks and bank holding companies, resulting in a substantial increase in actual and potential competition.

Respondent further understates the impact of the decision of the court of appeals by arguing that its holding reaches only "sponsorship" of closed-end investment companies (Br. in Opp. 12). Respondent overlooks the language of the opinion, which clearly states that the court's holding prohibits "sponsoring, organizing, managing, or controlling such companies" (Pet. App. 49a). The only issue left undecided by the court of appeals is the permissibility of providing mere "advice" to closed-end investment companies, apart from the forbidden control, management, sponsorship, or organization. For this reason, the Board's authority to adopt a new regulation is severely curtailed.

In sum, by adopting an erroneous and unduly restrictive construction of Section 4(c)(8) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(8), the court of appeals has barred the Board from authorizing bank holding companies to perform services that are closely related to the service of portfolio management customarily provided by banks, a result that is contrary to the mandate of Congress. In addition, by defining the scope of activities permissible to bank holding companies

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[1]See Wiesenberger, *Investment Companies Service*, "Management Results" 572-575 (September 1979). Respondent repeatedly argues that such management activities by banks are illegal (see Br. in Opp. 8, 15, 16, 18).

by reference to vague standards of securities-relatedness—instead of relying on the literal language of the Glass-Steagall Act and the Bank Holding Company Act—the decision below obscures the dividing line between the securities and banking industries and deprives those industries of effective guidance in the conduct of their operations.

2. Respondent's central argument in support of its assertion that bank holding companies may not manage closed-end investment companies is that such activities are "expressly forbidden to banks" (Br. in Opp. 7-8, 15-16, 18).[2] This argument is both erroneous and irrelevant. It is erroneous because the Glass-Steagall Act does not forbid banks to manage closed-end investment companies within appropriate limitations. And it is irrelevant because both the Glass-Steagall Act and the Bank Holding Company Act permit bank holding companies to engage in a substantially broader range of activities than banks.

a. The activities authorized to bank holding companies by the Board's regulation are not forbidden to banks under the Glass-Steagall Act. The Board's regulation imposes numerous restrictions designed to keep the authorized activities within the ambit of lawfulness under the Glass-Steagall Act. See 12 C.F.R. 225.125(d)-(i). Those restrictions—which effectively divorce investment management from the underwriting process and protect against conflicts of interest—are described in the Petition at pages 5-7. Although the opinion of the court of appeals ignores these restrictions, they provide effective protection against the "hazards" that concerned this Court in *Investment Company*

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[2]We note that respondent essentially ignores the rationale of the court of appeals in presenting this argument—further evidence, we submit, that the reasoning of the court below is untenable.

*Institute* v. *Camp*, 401 U.S. 617, 636-638 (1971). A bank operating within these restrictions would not be engaged in the process of issuing, underwriting, or distributing securities. See *id.* at 623-625.[3] As the Board has observed, the investment management activities that are described in its regulation are permissible both for bank holding companies and for banks under the Glass-Steagall Act (Pet. App. 61a-63a).

b. Moreover, there is no ground for respondent's assertion that the Bank Holding Company Act and the Glass-Steagall Act authorize bank holding companies to engage only in activities that are permissible for banks. The plain language of those statutes contradicts respondent's argument. Section 4(c)(8) of the Bank Holding Company Act permits bank holding companies to engage not only in banking activities, but also in activities that are "closely related" to banking. 12 U.S.C. 1843(c)(8). Section 4(a)(2) of the Act also states that bank holding companies may engage in the activities of "(A) * * * banking or of managing or controlling banks * * * and (B) those permitted under [Section 4(c)(8)]." 12

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[3]Contrary to respondent's assertion (Br. in Opp. 8, 16), this Court's decision in *Camp* did not forbid banks to manage all forms of investment companies. The Court in *Camp* was considering an investment fund equivalent to an *open-end* investment company, which is engaged in regular offerings and redemptions of its shares. See 401 U.S. at 625. The opinion in *Camp* does not suggest that a bank cannot operate a *closed-end* investment company within a body of regulations specifically designed to prevent abuses of the kind that concerned Congress when the Glass-Steagall Act was adopted. We also note that, in the present case, in contrast to *Camp*, the administrative agency has provided a detailed explication of its statutory interpretation and has demonstrated that it is compatible with the language and purpose of the Act. Compare 401 U.S. at 626-627 with Pet. App. 53a-64a, 65a-79a, 83a-87a. The Board's prior interpretations of the Glass-Steagall Act also have distinguished between closed-end and open-end investment companies. See 12 C.F.R. 218.101-102.

U.S.C. 1843(a)(2). The second phrase would be meaningless if "banking" activities alone were permissible under Section 4(c)(8). In addition, Section 4(c)(6) of the Bank Holding Company Act, 12 U.S.C. 1843(c)(6), expressly authorizes bank holding companies to purchase common stock for their own account—an activity that is clearly impermissible for banks. And as we have noted (Pet. 16-17), Section 4(c)(7) of the Act, 12 U.S.C. 1843(c)(7), expressly authorizes bank holding companies to purchase all or a part of the outstanding shares of an investment company.

The Glass-Steagall Act, like the Bank Holding Company Act, authorizes bank holding companies to engage in a broader range of business activities than banks. Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, prohibits bank holding companies from engaging "principally" in the issuance, sale, or distribution of securities. By using the qualifying term "principally," the statute clearly permits a secondary degree of involvement by bank holding companies in the distribution of securities. By contrast, Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. 24 Seventh and 378, flatly prohibit bank participation in the issuance or distribution of securities. See *Board of Governors* v. *Agnew*, 329 U.S. 441, 447-448 (1947).

In sum, respondent's argument is without foundation because management of closed-end investment companies is permissible for banks and because bank holding companies may, in any event, engage in a substantially broader range of activities than their bank subsidiaries.

3. Respondent also argues that Section 20 of the Glass-Steagall Act, 12 U.S.C. 377, does not define the scope of bank holding company securities activities, noting that Section 20 was not made applicable to bank holding companies until 1966 (Br. in Opp. 17-18).

However, Section 19(e) of the Glass-Steagall Act—the predecessor of Section 20—originally applied to bank holding companies and effectively barred them from controlling firms "engaged principally" in the distribution of securities (48 Stat. 188).[4] Section 19(e) was superseded in 1966 (80 Stat. 242-243), but the same legislation made Section 20 of the Glass-Steagall Act applicable to bank holding companies by revising the definition of bank "affiliate" and retained the "engaged principally" standard (80 Stat. 242). In sum, from the original enactment of the Glass-Steagall Act to the present, Congress has prescribed the same rule—bank holding companies are forbidden only to engage in those business activities that result in their becoming "engaged principally" in the issuance or distribution of securities. As discussed in the Petition, management of closed-end investment companies, within the limitations prescribed by the Board, does not infringe that standard.

4. Amicus Securities Industry Association suggests (Amicus Br. 6-7) that certain bills pending before Congress that would narrow the scope of Section 4(c)(8) diminish the importance of review by this Court in this case. However, similar legislation has often been considered by Congress but has not been enacted.[5] When Congress amended Section 4(c)(8) in 1970, it considered and expressly rejected a provision that would have barred bank holding companies from managing closed-

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[4]A bank holding company could not vote the shares of a bank subsidiary if it or a non-bank subsidiary was "engaged principally" in the investment banking business.

[5]Bills to modify Section 4(c)(8) have frequently been introduced in Congress but have failed to pass. See H.R. 11678, 93d Cong., 1st Sess. (1973); S. 2721, 94th Cong., 1st Sess. (1975); H.R. 13077, 94th Cong., 2d Sess. (1976); H.R. 11456 and S. 3087, 95th Cong., 2d Sess. (1978).

end investment companies (see Pet. 17-18). Congressional action on the proposed legislation cited by amicus is not imminent, and the recent actions of Congress in this area do not suggest that any active reexamination of the issues presented in this case is taking place.[6] Because the court of appeals has seriously misconstrued the statute that Congress actually enacted, and because congressional revision of the statute is not foreseeable at this time, review by this Court is warranted.

For these reasons and the reasons stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

WADE H. MCCREE, JR.
*Solicitor General*

JANUARY 1980

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[6]H.R. 2747, 96th Cong., 1st Sess. (1979), which concerns investment advisory services of bank holding companies, has not been approved by the House Committee on Banking, Finance and Urban Affairs or any subcommittee.